Internal Revenue Service

# memorandum

TL-N-2539-90
Br2:ORPirfo

date: MAR 8 1990

to: District Counsel, Boston
Attn: Christine Colley

from: Assistant Chief Counsel (Tax Litigation)

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subject: [redacted]
Application of the Consolidated Returns Regulations and the Proper Party to Execute Forms 872 and to be Served with Notice of Deficiency.

This responds to your request for tax litigation advice, dated January 30, 1990, concerning the above-referenced taxpayers.

## ISSUE

Which are the proper parties for purposes of executing Forms 872 to extend the period for assessment of income tax and to receive any statutory notices of deficiency with respect to consolidated group return years where the former common parent of the consolidated group has gone out of existence by merger into one of its first-tier subsidiaries and the only other subsidiary member of the affiliated group was spun-off immediately prior to the aforementioned merger?

## FACTS

The facts as stated herein were chiefly recited in your request and were further developed from a review of the file submitted with that request.

[redacted] (hereinafter [redacted]), as its sole assets, owned [redacted]% of the stock of [redacted] ([redacted]) and [redacted]% of the stock of [redacted] ([redacted]); [redacted] filed two consolidated returns with these subsidiaries for a full taxable year ended [redacted] and a short taxable year from [redacted] through [redacted]. The stock of [redacted] was owned [redacted]% by an individual.

On [redacted], the closing date of [redacted]'s final consolidated return, the following transactions occurred: (1) the stock of [redacted] held by [redacted] was distributed to the [redacted] sole shareholder and, subsequently, (2) [redacted] merged into its subsidiary [redacted], pursuant to state law, with [redacted]

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terminating and its stock cancelled and with [redacted] remaining as the surviving corporation.

The foregoing transactions purportedly were undertaken so as to qualify [redacted] for Subchapter S eligibility under I.R.C. § 1361. [redacted] filed its initial separate return as a Subchapter S corporation for the period [redacted] through [redacted].[1]

DISCUSSION

Treas. Reg. § 1.1502-77(a) sets out the general rule that the common parent of an affiliated group, with certain very limited exceptions not relevant here, shall be the sole agent of each subsidiary in the group "for all purposes," including, inter alia, receiving notices of deficiency and executing any waivers on behalf of the group in all matters relating to tax liability for the consolidated return year.

When, as in the instant case, the common parent has gone out of existence subsequent to the consolidated taxable years in issue and, consequently, is unavailable to exercise this agency authority for the group, Reg. § 1.1502-77(d) provides three options: (1) the common parent, before it dissolves, can designate another member of the group (subject to the approval of the district director) for particular consolidated tax years as the new agent; (2) if the old common parent has not made such a designation or approval has not been received, the remaining members for that year can designate (again subject to approval) another member to act as such agent; or (3) if neither of these two designations have been made or the district director has not approved such a designation, the district director may "deal directly with any member in respect of its liability." Under Treas. Reg § 1.1502-6(a), generally, each member is severally liable for the full tax of the group for a consolidated year.

The Service has taken the position that, since a corporation is a juridical entity and most state merger statutes provide that the nonsurviving merged corporation terminates, a common parent does go out of existence following any merger where the common parent corporation is not the survivor.[2] As a general rule, under Treas. Reg. § 1.1502-75(d), a consolidated return group ceases to exist when its common parent goes out of existence.

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[1] While not relevant to the discussion herein, it is not clear what the subsequent filing and periods of [redacted] have been since it left the [redacted].

[2] This Service position, of course, does not preclude liability for the consolidated years being asserted against the survivor as a transferee or successor to the common parent.

This rule, however, does not apply in the circumstances of a 368(a)(1)(F) reorganization, certain "downstream" transfers of a common parent's assets, or a "reverse acquisition" situation (see infra).

Since the common parent has gone out of existence here and no designation of a new agent has been made and approved under § 1.1502-77(d), the issue of which, if any, corporation to deal with as the new agent of the group revolves upon resolution of the applicability of the "reverse acquisition" exception and the two other exceptions to -77(d) noted above. As explained below, all three exceptions seem inapposite here; thus, we would recommend that the two extant members of the [redacted] group be dealt with directly by the district director. Both [redacted] and [redacted] should each execute separate Forms 872 for the taxable years in issue and receive any notices of deficiency for the periods should such service be necessary.

There has been no § 368(a)(1)(F) reorganization. See Treas. Reg. § 1.1502-75(d)(2)(i). [redacted], as part of the same plan of reorganization as the merger with [redacted], transferred substantial assets (the [redacted] stock) to one other than [redacted]; thus, it has not undergone a "mere change in identity, form, or place of organization." Id. Therefore, § 1.1502-75(d)(2)(i) does not apply.

Similarly, the exception for "downstream" transfers of assets to a subsidiary under Treas. Reg. § 1.1502-77(d)(2)(ii) is also inapplicable. While this provision may initially appear to cover the [redacted] situation, the fact that the [redacted] stock was spun-off to the sole shareholder before the [redacted]/[redacted] merger causes the resultant restructured group to fail to meet that regulation. The regulation requires that "there remains one or more chains of includible corporations connected through stock ownership." Treas. Reg. § 1.1502-77(d)(2)(ii). Once [redacted] and [redacted] merged, no "chain" of corporations any longer existed.[3]

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[3] Compare Rev. Rul. 82-152, 1982-2 C.B. 205. Group included parent (P), a first-tier wholly-owned subsidiary of P (S), and a wholly-owned subsidiary of S (T); P and T merged, with P surviving, and the stock of S owned by P was cancelled so that the result was that P became a subsidiary of S. Held: the group remained in existence because the transaction was "indistinguishable in substance" from that described in § 1.1502-75(d)(2)(ii) since the formal restructuring did not effect any substantial change in the composition of the group as judged by reference to the underlying assets; however, S did become the new common parent. On the facts of that ruling, an affiliated group (or "chain") remained.

In addition, there is no "reverse acquisition" under Treas. Reg. § 1.1502-75(d)(3). The acquiring corporation here, [redacted] was itself never a common parent of an affiliated group since [redacted] was spun-off before the merger and [redacted] never held [redacted] stock. See Southern Pacific Co. v. Commissioner, 84 T.C. 375, 383 (1985). While the rule is designed to eliminate the discretion that the shareholders of two merging groups might otherwise have to determine which group survives (see id.), the rule has no application when no group at all remains after the relevant acquisition.

In sum, since the common parent ([redacted]) for the consolidated years in issue has gone out of existence and the required interconnecting stock ownership link that created an affiliated group has been broken, the only pertinent regulatory provision would be § 1.1502-77(d). Absent any designation and approval thereunder, as described above, the district director should deal directly with each of the two corporations that were members of the group for the consolidated taxable years involved here. Hence, separate Forms 872 or 872-A agreeing to extend the time for assessment should be executed by [redacted] and [redacted] and any notices of deficiency should also be served on each corporation separately.

RECOMMENDATIONS

The district director should deal directly with each of the remaining two corporations that were members of the [redacted] consolidated group. Both [redacted] and [redacted] should execute Forms 872 to extend the period of limitation on assessment. Both remain severally liable for the whole tax of the consolidated group. Should a notice of deficiency be necessary for either or both consolidated taxable years under audit, both corporations should be served separately with notices of deficiency.

Further, in response to the Examinations Division's inquiry as to the specific wording of the Forms 872, the name of the corporation to which that Form 872 has been directed should appear atop thereof as being clearly responsible for any group liability, i.e., "[redacted]" or "[redacted]" with an asterisk to the foregoing title citing the former subsidiary's several liability for the entire consolidated group tax for the years in question. For example, "[redacted]*" and the asterisk note stating "* -- With respect to its several liability for the income tax of the [redacted] consolidated group. Treas. Reg. § 1.1502-6(a)."

Notwithstanding our conclusions herein as to what is the correct procedure for dealing with these former group members under the consolidated return regulations, in order to provide

extra protection of the revenue and to foreclose any possible future argument by the taxpayer, we would also recommend that [redacted] be given written notice that [redacted] and [redacted] are being dealt with directly by the district director. By providing such notice in this case anyway, the Service would prevent any future claim, albeit unfounded, that [redacted] was somehow entitled to such notice but did not receive it.

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